

FY2018 Interim Financial Results
Investors' Meeting (Held on Nov. 9) Q&A English Transcript

Q: My question is the difference between the first half and second half, especially loan growth. consumer loans, especially Lake loans. Even the first quarter, because of the brand changes not being fully spread. On the other hand, project finance has significant growth in terms of percentage. In the second half, for each, do you think that same trend will continue, or do you expect any change, including the total move of the balance?

A: Well, first, the unsecured loan business, you should not be overly concerned about this. The challenges for this business, the shift to the new brand, Lake ALSA and related challenges. And we are implementing analysis of causes and taking measures. We are accumulating those measures in a very careful manner. I cannot mention about the latest momentum after October. However, we are seeing effects of initiatives taken and it's an improving trend. My concern about this business is as I mentioned earlier, there is no major effect or impact on this fiscal year's P&L. But considering the next fiscal year's P&L, how much the balance of this fiscal year will have the impact on next fiscal year's performance. Effects of the initiatives taken need to be realized as soon as possible. And that is our biggest challenge. And we are starting to see effects. In that sense we are not too much worried about this business. But how we can accelerate the initiatives is important.

First, we want good customers to come to us. I think that is important. When they want to borrow, we want customers to think about Lake ALSA and either at our branches or on the web, whether they can, come to us and after starting the process, without giving up in the middle, whether they can complete the process. And initiatives to realize this have been taken. A number of applications and approval rate will be increased through these initiatives.

And, regarding project finance, earlier, Mr. Hirano mentioned a little about this. There was a proposal and they were gathering public comments. The details are not known yet. But, anyway, as a trend, the FIT price, we were aware that the FIT price would decrease.

In the future, in the short term, in the transition period, what would be the likely impact, or confusion? In the short-run, that will be a risk factor. But, for others, so far, there is no such impact for overseas. The growth may slow slightly. But I don't think this is going to be a major factor to drag our feet. That is all.

Q: I have two questions. First of all, capital cost. And the other is the recent announcements with regards to alignment with other entities. On capital costs, at this timing, you're taking this

questionnaire, what is the backdrop? You're asking this question and internally, what do you think is the appropriate level of capital cost. To the extent possible, we would like to hear your views. That's my first point.

And secondly, on press releases on alignments, in the most recent months, you've been quite aggressive in issuing press releases on new business areas and alignment with other entities. Mr. Kudo, at this juncture, taking into consideration such initiatives, what are your expectations with regards to alliances? Who are the partners with whom you have high hopes for alliances delivering results?

A: First of all, on capital cost, let me take that question first. In fact, today, I didn't know that we were going to ask you to fill in the questionnaire. The question was made by our IR team. But we've asked you to give your responses and I don't want my comment to sort of invite the optimum answer from you before you've written in your response. But capital cost is a natural question that investors ask in these sessions. So, let me briefly explain to you how we view this matter. Think of this as a parameter and there's a range. In the corporate governance code, it says you have to be accurate. But precision is very difficult. But, crudely speaking, I think it's somewhere between 8% and 10%. And also, ROE is hovering around 6%. So, from such perspective, we probably want to have in our minds a benchmark of around 8%, as we run the bank. 8% isn't enough, of course some may say. But of course, we would very much appreciate your frank feedback. So, please write the responses to the questionnaire.

On alliance, it's not that we want to cause fanfare through the press releases. Each initiative has its own meaning and what we think is most important is to find someone who already has a robust platform who would have a different perspective than ourselves. And who owns data on customers or potential customers from the different angle than the data we have. Those would be the key alliances. Especially when it comes to retail customers, this kind of strategy would apply. We are dealing with financial products and financial services and no longer are they being offered on standalone basis. We need to cooperate with major platformers because the ratio of financial services being offered via such major platform is increasing.

DoCoMo platform to be used for offering unsecured loan was announced. Frankly speaking, we are not sure to what extent that business will grow. But we place weight on this kind of initiative and partnership. By the way, to give you one other comment, the value lies in DoCoMo's platform. So, that's where the added value is, meaning that on relative basis, our value we offer, in terms of financial service, is relatively lower. And yet, this is an important project, as I said. Another point, we don't think that the services have reached a sufficient level. There are still underserved customers. We want to establish a mechanism that will provide for a similar system as the customers who are well served. And that is why we are seeking partnerships. I think we need to

look at this from both sides.

Q: I have two questions. One is about, the right-hand side of page 10, the forecast for the net credit cost. Looking at this, APLUS is on a gradual uptrend and consumer finance is flat or still on downtrend. And the structured finance is slightly on the uptrend. I think that's a fair view. And is it correct? And in total, the ratio, the net credit cost, not the credit cost itself, the net credit cost ratio, can you maintain it flat?

The second question is regarding page 20, on the left-hand side, net interest income by segment. Consumer finance and structured finance alone is 1.8 billion yen. And retail, probably this includes spread of the foreign-currency deposit and treasury through the change on the currency forward, for the currency swap. So, sustainable interest income seems to be declining. And what is the expected growth of the interest income. Currently, it's 3.4%. Should we consider that this would continue to decline?

A: Net credit cost. Consumer finance and structured finance should be considered separately. And the former, the net credit cost should be controlled as one of the drivers. Centered on Lake, unsecured loan world and overall, we consider it to be flat. But my little concern is, rather than ourselves, as a market, the customers' credit standing, there are some signs of deterioration. So, we are cautious on that. In that sense, we will control credit costs. But, as a total of the credit cycle, I think we are near the bottom. And that can be said for APLUS, as well. We don't think our number will increase. But, as a total trend of the market, we need to be cautious.

On the structured finance, for several years, the credit cost has been very low. There is no information material that this will significantly deteriorate. But, rather than this will decrease further, rather it's going to be flat, we need to look at it a little conservatively.

And regarding net interest income growth, whether the growth will slow down I was not considering so. But, if you look at the largest chunk of this chart, which is unsecured loans, it depends on the move of this portion. As you are being concerned, depend on the growth of the Lake business. This is significantly linked with the growth of the business. However, as I mentioned earlier, we have been taking a lot of initiatives. So, we need to confirm the effects of the initiatives and the growth of the business can be maintained through those initiatives.

Q: How about your retail banking and treasury? So, there is not much sustainability for these two?

A: Well, in retail banking, no sustainable initiatives are included in here. Treasury, rather than growth, it depends on the market. And so, there are ups and downs. So, as you said, it could increase or decrease.

Q: Two questions. First of all, on Lake ALSA, against the original plan, you are behind, and you analyzed the factors behind. And, as a result of the analysis, what do you think about the measures that have been introduced? Do you think the measures or initiatives were inappropriate? Or do you think that the market view was rather optimistic and there had been more negative factors in comparison to the market view?

Secondly credit costs in general. On page 10, on the left-hand side, project finance, review of the overseas project finance had led to review of parameter. This is a one-off event and this will no longer impose impact. And on the right-hand side, former-Lake portfolio recovery, this had happened in the past a few times. But will this be the last round of credit recovery from former-Lake portfolio?

And lastly, in the case of Shinsei, APLUS condominiums for investment, it is my understanding that they are used apartments or small ticket items or on land lease basis. It's not the kind of the market issues that are making the headlines. So, in the first half, you didn't provide for special reserve. But, do you think that it will be unnecessary to provide for a special reserve for this asset?

A: On your question, with regards to page 10 and the point related to structured finance, recovery of credit cost, reversal of reserves. Yes, this is a one-off event. It's not that this will be recurring term after term. And, Lake-related point. Sorry, I didn't really get your concern.

Q: Former-Lake portfolio, is this the last time of reversal or do you think there is still some buffer and there is still room for more recovery in the future?

A: Well, it's difficult to answer because provisioning is being done at an appropriate level. So, I can't say that we've provisioned more than we should have. So, there would be reversal term after term. But if you compare our reserve ratio against our peers, I think that we have quite sufficient headroom. That is the position in terms of reserve. And that's all I can say.

APLUS, condominiums for investment purposes. As you have indicated, our group company, APLUS is engaged in condominiums for investments and this is unit sales of secondary condominiums in the order of dozens of millions of yen. We do not consider that this business will

cause any short-term issues. Also, these apartment type loans or Suruga's issue, even before they became problems, we began to feel that there is rather over-heatedness in the market. The risk policy had been made stringent, even before those problems emerged. And we have no intention to aggressively try to grow this business. In the market-wise, real estate-related market apartment loans from the general public's perspective, due to those criticisms, the number of loan lenders is declining. In terms of the real estate market pricing situation, I think there is high likelihood that the market will become rather bearish. It's not that we are taking direct access to such markets. But, for example, there are institutional investors and have certain condominiums for lease in their large portfolio and the exit may involve individual retail investors. So, there could be indirect impact to the market from such channels. To a certain extent, we are trying to be vigilant. But, as I said, it's not that there is a probability of certain problems giving rise in our own portfolio.

Regarding Lake ALSA market factors, the initiatives and market factors, first, how do we see the market, especially the slowdown of bankcard loans, that is true. And, because of that, the total market growth is declining. But, under the moneylending industry, the business is having the tailwind. I think that's your overall market condition.

But, anyway, in the medium to long run, gradually the growth will slow down, which I have been mentioning. The recent Lake ALSA incident is rather than the market slowdown, the brand transition; it was a direct impact of that transition. We have explained the causes so, I'm not going to repeat the details. Rather than the initiatives failed, rather there was some unavoidable situation because we changed the brand and we renewed the website as well. How do we appropriately guide or navigate customers to that? It's impossible to do this instantly. At the entrance, it's sort of unavoidable. But, as I said, I hope that we should put this on the growth track a little faster. And we have taken initiatives and we have started to see effects but, again, our challenge is how to accelerate those initiatives or effects.

Q: I have one question. For several years, your domestic offices were closed. But, at this moment, what is the effect? In terms of cost and business, are there any negative factors or negative impacts? Could you please tell us effects based on the closures, any similar initiatives, for example, drastic change of the branch models? Could you please tell us if you have such implication through these recent closures?

A: Well, I would like to answer your question by separate cases. The initiatives taken were those that we expected the clear effects. And those were the higher priorities. In that sense, we have seen expected effects. In terms of downside, honestly speaking, I have not seen major downside.

So, those initiatives were successful.

Going forward, retail and Lake business, the unmanned branches of Lake business, and the offices of the entire group or our call centers. Roughly, we need to divide this issue into those three categories. In terms of our offices, our asset management offices, the most profitable customers are customers who come to face-to-face. And considering the Japanese situation, the business model with no face-to-face channel or branches, it is very doubtful whether such model will be successful.

But such business model has cost issue. How should we leverage the face-to-face channels or branches? Other banks are also doing this, for example, so-called omni-channel. How organically should we coordinate as omni-channels? To improve the UX of the aged customers, I think, will lead to the differentiation. It's not just to decrease the channel. But, as the major trend, physical branches, the proportion of the physical branches will decrease. The face-to-face channels are not necessarily physical branches. We have virtual channels or facilities using those tools such as video. And the Lake's unmanned branches, we have closed, we have done the scrap and build and looking at the market condition. So, we will open the branch where we can expect effects. And if we were not successful, we will close them. We will just continuously scrap and build. The proportion of the physical branches will decrease in the future. I think that is a trend.

And lastly, our offices or call centers. They have room for productivity improvement. Each box or office is large and we also need to consider the expiry of these agreements for planning. Though, in the short run, no drastic initiatives are considered. But it is a big theme for our group. And, we believe that there is a large room for improvement in this area.

Q: About the midterm business plan. Where are you at the moment? What kinds of discussions are currently underway? And how do you position the plan, harvesting from the current midterm plan? Is that the positioning of the next midterm plan? Or do you think that it will be a timing to show new direction? If you could, please put the upcoming midterm plan in context.

Secondly, on nonorganic opportunity, you mentioned in your presentation that you're constantly looking for opportunities. But, under the existing priority, what are the areas, in Japan and outside of Japan, in terms of nonorganic growth?

A: The midterm plan is currently being deliberated and there's nothing specific that I can share with you at this point in time yet. But, thinking about the current surrounding business environment in the financial sector, we don't think that we can afford to be relaxed in the next three years just by sitting on the harvest from the current plan. So, there will be several new

factors to be embedded into the upcoming plan.

I touched upon the alliance with platformer which will be one factor, or creating our own accommodating ecosystem would surely be part of it. The core product and service will not fundamentally change. But, the means in which we will be offering those products and services may change quite drastically. In response to such change, the profile of the business may change. Sorry, but please wait for a few more weeks or months until we make an announcement. Now, nonorganic opportunities, there are a few that we are focusing on. Banking business is not really the core of our focus. So, naturally, our focus will be non-bank area. Japan versus outside of Japan. The way business is done is different. We don't think that pure Japanese business model of unsecured loans can be transplanted as they are overseas, and they would have to be adjusted market-by-market. But I think the credit offering to individuals would be the biggest area of focus. And then, the next one will be small loans to corporate's, like lease in way of products. So, we're looking at both the domestic as well as overseas market.

Q: Regarding the unsecured market and my second question is regarding ROE. As there were questions, on page 26 there is a total growth of the unsecured loan market. In total, the growth is less than 2% for the bankcard loan. There is a sense of slowing down. The bankcard loans are slowing down, and the moneylenders are facing a follow wind that was commented. But, looking at the total situation, this bold dark blue line appears that your total market is shrinking. But the president mentioned that the credit is deteriorating slightly and so we need to be a little cautious. Why is it happening? The total market is shrinking. However, the credit standing is deteriorating if that is happening. Why is that? Could you please explain it?

And ALSA, under such circumstances, the moneylenders' growth is about 4% to 5% and ALSA will recover if the growth will be recovered to this level, then the credit costs will be between 4% and 5%. I think that is what it means by the flat. Is my understanding correct?

And, my second question, the ROE, first you are targeting to increase from 6% to 8%. But, through the collaboration with the other sectors, and offer services on such platforms, then the unsecured loan business will decrease. However, the non-much profitable fee business will increase. So, this ROE 6% to 8% is 25 points increase. It's a very aggressive target. How are you going to achieve the 8%? I'm sorry for a little vague question but that is my second question.

A: First, unsecured loans. As you pointed out, there is an issue of the market size and credit of the customers. Rather than confirming the numbers, this is a lot of discussion of impression. I think these two are linked. And the size of the market, the growth is slowing down. But rather than this is the problem or the issue of size of the market, this is the issue of the business stance

of the service providers. Bankcard loans have become a social problem and policies were declared by banks and such initiatives are being implemented. And, the move is becoming a little less aggressive. It's not the problem of the demand. I think more of the problem of the supply-side. In the medium-term perspective, we think that this will slow down. But, for the short term, this is triggered by these responses to problems as a reaction. So, such short-term factors are the majority, I think. I do not call this credit crunch. But the people who were able to borrow are not able to borrow any longer. So, that led to the impression that the credit standing is deteriorating. If the demand and supply match naturally, then we believe that we can remove the concerns that were mentioned earlier. And Lake ALSA, as you pointed out, the average of the moneylending business growth should be able to achieve such average growth. And we are working in order to achieve it, and we are in the middle of catching up.

Regarding capital costs of 6% to 8%, this is similar discussion to the BOJ's inflation target like the target must be 2%. But we see the current ROE number is too low. Based on such understanding or recognition, we need to increase it and for the time being, we should target or aim at 8%. We are not developing plans starting from this 8%. That is not the case. But I'd like to comment on the points raised. Participating in a large platform, as explained, the relative value added can be smaller than the value provided by existing businesses. On the other hand, the individual initiative with DoCoMo, the detailed business model has not been explained yet and we cannot explain it at this moment. But, for individual customers, not just the credit standing at the entrance but of course, this requires the credit control. A lot of services to customers and collection at the end, everything will be required. Players having such skillsets are not so many in Japan. In a sense, this is a little conceptual observation. Whoever the partner will be, we believe that we can achieve this effect and we are considering to create ecosystem for the foreign national workers. This is one of the two comments I would like to make. And another thing is our nonorganic initiatives. Our capital ratio, compared to megabanks who are operating in overseas business is already comparable. We need to use this capital more. Accordingly, we are mentioning the nonorganic initiatives. So, we would like to make efforts to achieve, as close to 8% as much as possible. It's not something that we are doing this for totally unachievable.

FY2018 Interim Financial Results
Overseas Investors Teleconference (Held on Nov. 8) Q&A Transcript

Q: I wonder if I could just ask you a quick question about the provisioning volatility on structured finance. That seems to move around rather a lot. You put 1.9 billion yen in the first quarter, and 4.9 billion yen out in the second quarter. I understand that's mostly formulaic. Could you explain a little bit more how that formula's working? And what creates the volatility?

A: Firstly, I think it should be viewed as a one-time activity. Let me give you a little bit of background. As you know, we are new to project finance business both domestic and overseas. When we commenced this business, we didn't have historical data to benchmark our credit reserve ratio. So, we had been conservative in our reserving policy with regards to both domestic and overseas project finance transactions. But in the course of the last three to four years, we have built a sizable portfolio, as you can see from the numbers, which gives us ability to do a more robust reserving methodology or reserving calculation for the first time, which resulted in, as you outlined, roughly 5 billion yen in net reversal. Yes, I fully agree that there is a significant fluctuation between first-quarter and second-quarter. But we believe that going forward because we have now established a more robust credit reserving methodology for this business. We should not see or envision fluctuation in the reserve ratio or the credit cost for this business, going forward.

Q: Quick question about the Kabarai reserves. Your reserve balance is looking increasingly excessive, given the decline in cash, you know, repayments. Your release from the reserve, I think, was 1.8 billion yen this quarter. Why was it only 1.8 billion yen and not larger, and how are you thinking about that going forward?

A: As you know, we've been observing the trend very carefully. Every semiannually, we true up our reserving methodology based on the total gray zone cost, as well as the disclosure claims. As you know, the first quarter, we saw a small uptick, in fact in disclosure claim and it's finally coming down. So, the 1.7 billion yen reversals in the first half is strictly the outcome based on the trend that we see, you know, up until this point in time. Should the disclosure claims or the total gray zone cost decline steeper than what we have observed thus far, then definitely it would result in higher result release. And conversely, if we see flattening of disclosure claims, then we may not be able to reserve, reverse, our gray zone reserve as much as we did in the first half. So, it will simply be a factor of how quickly the disclosure claims decline, going forward. (End)